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In the Supreme Court of the United States

OCTOBER TERM, 1996

TRISTAR CORPORATION, PETITIONER

v.

ROSS A. FREITAS AND CAROLYN SAFER KENNER

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether the two-year statute of limitations for commencing an action to recover an insider's short-swing profits under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b), begins to run when the insider files the reports required by Section 16(a) of the Act, 15 U.S.C. 78p(a), that disclose the short-swing transactions.

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This brief is submitted in response to the Court's order inviting the Solicitor General to express the views of the United States.

STATEMENT

1. Congress enacted Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b), "to curb short-swing trading by insiders whose position gives them access to information not available to the investing public." *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 592 n.23 (1973). Section 16(b) of the Act provides, *inter alia*, that an issuer or a holder of its securities may bring an action against any director, officer, or beneficial owner of more than ten percent of the corporation's out-

standing shares to recover the insider's profits "from any purchase and sale, or any sale and purchase, of any equity security of such issuer * * * within any period of less than six months." 15 U.S.C. 78p(b). Suits under Section 16(b) may be brought at law or in equity by the issuer, or by the holder of any security of the issuer "in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter." 15 U.S.C. 78p(b); see *Gollust* v. *Mendell*, 501 U.S. 115, 122-124 (1991). Section 16(b) further provides that no suit for short-swing profits "shall be brought more than two years after the date such profit was realized." 15 U.S.C. 78p(b).

Section 16(a) of the Act, 15 U.S.C. 78p(a), establishes a mechanism for notifying issuers and security holders of short-swing transactions, thereby facilitating actions for recovery of profits under Section 16(b). Under Section 16(a), insiders must disclose any change in their ownership of securities "within ten days after the close of each calendar month" in which such a change occurs. 15 U.S.C. 78p(a). Insiders must comply with the disclosure requirement by filing a report, known as a "Form 4" report, with the Securities and Exchange Commission (SEC or Commission). See 17 C.F.R. 240.16a-3(a). That report is made available to the public. See Pet. App. 6.

2. Respondents Freitas and Kenner served as officers and directors of Ross Cosmetics Distribution Centers, Inc., and were beneficial owners of more than ten percent of the outstanding shares of the company's common stock. In transactions occurring in February, March, May, and June of 1989, respondents purchased more than 39,000 shares of Ross

Cosmetics at prices ranging from $1.10 to $4.50 per share. Pet. App. 3.

On May 31, 1989, respondents entered into a contract to sell to Starion International Limited (Starion) a total of 906,594 shares of Ross Cosmetics common stock, which represented approximately twenty-eight percent of the company's outstanding shares. The agreement between the parties required respondents to transfer the shares to Starion in more than a dozen installments. In return, respondents were to receive "loan disbursements" fixed at between approximately $4.65 and $7.50 for each share in each installment. Through this transaction (and others), Starion acquired control of Ross Cosmetics, later renamed Tristar Corporation, petitioner here. Pet. App. 3-4.

3. On December 16, 1993, petitioner filed this action against respondents, pursuant to Section 16(b) of the 1934 Act, to recover respondents' short-swing profits from the transactions described above. Pet. App. 4. On August 8, 1995, the district court entered summary judgment for petitioner. *Id.* at 12-26. It held that respondents' May 31, 1989 agreement with Starion constituted a "sale" of securities within the meaning of Section 16(b), and that respondents had realized short-swing profits from the agreement. *Id.* at 17-19.

The district court rejected respondents' contention that petitioner's action was barred by Section 16(b)'s statute of limitations. Pet. App. 19-21. The court observed that the relevant purchases occurred between February 2, 1989, and June 15, 1989; that the sale of

shares occurred on May 31, 1989[1]; and that petitioner filed its complaint on December 16, 1993. "Accordingly," the court concluded, "if there is no tolling with respect to section 16(b) claims, [petitioner's] action is clearly untimely." *Id.* at 19. The court further observed, however, that respondents did not timely file Form 4 reports disclosing the short-swing transactions, as required by Section 16(a). *Id.* at 14. The reports, which were due on June 10, 1989, were not filed by respondents until more than two and a half years later, on December 18, 1991. *Id.* at 5, 14, 21. Following the reasoning of the Ninth Circuit's decision in *Whittaker* v. *Whittaker Corp.*, 639 F.2d 516, cert. denied, 454 U.S. 1031 (1981), the district court held that the limitations period in this case did not begin to run until respondents filed their Form 4 reports on December 18, 1991. Pet. App. 8, 20-21. Because petitioner filed its complaint on December 16, 1993, less than two years after respondents' belated disclosure under Section 16(a), the court held that the complaint was timely filed. *Id.* at 21. It entered judgment against respondents Freitas and Kenner for $101,004 and $81,893.75, respectively, plus prejudgment interest. *Id.* at 25-26.

4. The court of appeals reversed. Pet. App. 1-9. It held that, even if noncompliance with Section 16(a)'s filing requirements tolls the limitations period for Section 16(b) claims (a question the court declined to decide), petitioner's action was untimely. The court

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[1] Because the last of the relevant purchases occurred on June 15, 1989, the court of appeals may have erred (at least with respect to some of the profits) in concluding that the final date of the realization of profits, for purposes of Section 16(b), was May 31, 1989. Petitioner, however, does not appear to challenge that determination before this Court.

acknowledged that Section 16(a)'s notice requirement "provides a mechanism for facilitating the recovery of short-swing profits" under Section 16(b), because "[w]here the requirements of section 16(a) are met, the corporation or shareholder may determine easily and quickly whether any statutory insider has profited from a short-swing transaction by examining the Form 4s." *Id.* at 6. The court concluded, however, that petitioner's delay in filing Form 4 reports at most "suspended" the running of the limitations period during the time that the reports were delinquent. *Id.* at 7. In so holding, the court expressly disagreed with the approach taken in *Whittaker* v. *Whittaker Corp.*, *supra*, under which the full two-year limitations period does not begin to run in the first place until the delinquent reports are filed. Pet. App. 8.

Applying the foregoing analysis, the court of appeals held that petitioner's claim accrued when respondents realized their profits on May 31, 1989. Because respondents were not required to disclose the short-swing transactions until "ten days after the close of [that] calendar month," 15 U.S.C. 78p(a)—and because petitioner's putative ignorance of the claim prior to that filing deadline did not result from any lateness in respondents' filing of their reports—the court concluded that the limitations period ran from May 31 until June 10, 1989 (a period of ten days). Pet. App. 7-8. The court assumed, *arguendo*, that the limitations period was then tolled from June 10, 1989, until respondents filed their Form 4 reports on December 18, 1991. In the court's view, the remaining limitations period of two years less ten days began again on December 18, 1991, and expired on December 8, 1993. Because petitioner filed its complaint eight

days later, on December 16, 1993, the court held that the action was untimely. It therefore reversed the entry of judgment for petitioner and directed the district court to dismiss petitioner's complaint. *Id.* at 9.[2]

DISCUSSION

The court of appeals' decision is incorrect and conflicts with the Ninth Circuit's decision in *Whittaker* v. *Whittaker Corp.*, 639 F.2d 516, cert. denied, 454 U.S. 1031 (1981). Although the precise limitations issue in this case has not been widely litigated and results in a difference of at most 40 days in the applicable limitations period, we believe, on balance, that review by this Court is warranted. The two circuits that have addressed the question account for a large proportion of the Nation's Section 16(b) litigation, and there is a need for certainty in the area of limitations periods. The petition for a writ of certiorari should therefore be granted.

1. The court of appeals concluded that, because respondents' short-swing profits were realized on May 31, 1989, petitioner's claim necessarily accrued on that date. Any subsequent noncompliance with Section 16(a)'s reporting requirements, the court reasoned, could at most "suspend" the running of the

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[2] The court of appeals observed that there was evidence that petitioner had actual knowledge of respondents' short-swing transactions when the corporation disclosed information about the transactions in a Form 8-K report on June 5, 1989, before the Form 4 reports were due. The court did not decide, however, whether petitioner had actual knowledge of the information that would have been disclosed in the Form 4 reports, or, if so, how that disclosure might affect the tolling of the limitations period. Pet. App. 8 n.2.

limitations period under equitable tolling principles. Pet. App. 7-8. That conclusion disregards the well-established "discovery rule" that is generally applicable to federal limitations periods, and it is contrary to the purpose and structure of Section 16 as a whole.

This Court has long held that, "where the party injured by the fraud remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute does not *begin to run* until the fraud is discovered, though there be no special circumstances or efforts on the part of the party committing the fraud to conceal it from the knowledge of the other party." *Bailey* v. *Glover*, 88 U.S. (21 Wall.) 342, 348 (1874) (emphasis added); see also *Holmberg* v. *Armbrecht*, 327 U.S. 392, 397 (1946) ("This equitable doctrine is read into every federal statute of limitation."). That principle, moreover, has not been limited to cases in which fraud is alleged. See *Urie* v. *Thompson*, 337 U.S. 163, 169-170 (1949) (employee's cause of action under the Federal Employers' Liability Act for contracting silicosis accrued when he discovered his injury); *United States* v. *Kubrick*, 444 U.S. 111, 120-121 n.7 (1979); see also *Connors* v. *Hallmark & Son Coal Co.*, 935 F.2d 336, 342 (D.C. Cir. 1991) (R.B. Ginsburg, J.) (noting consensus among courts of appeals that "discovery rule is the general accrual rule in federal courts" and "is to be applied in all federal question cases 'in the absence of a contrary directive from Congress'") (quoting *Cada* v. *Baxter Healthcare Corp.*, 920 F.2d 446, 450 (7th Cir. 1990), cert. denied, 501 U.S. 1261 (1991)).

Under the "discovery rule," a cause of action does not accrue until the plaintiff discovers, or reasonably should have discovered, the facts that form the basis for the action. See, *e.g.*, *Exploration Co.* v.

United States, 247 U.S. 435, 447 (1918); see also *Cada* v. *Baxter Healthcare Corp.*, 920 F.2d at 450 ("Accrual is the date on which the statute of limitations begins to run. It is not the date on which the wrong that injures the plaintiff occurs, but the date—often the same, but sometimes later—on which the plaintiff discovers that he has been injured."). As applied to claims under Section 16(b), the discovery rule operates to ensure that the limitations period does not begin to run before a plaintiff discovers, or reasonably should have discovered, an insider's short-swing transactions. Cf. *United States* v. *Ibarra*, 502 U.S. 1, 4 n.2 (1991) (per curiam) (explaining distinction between circumstances that "suspend[]" the running of a limitations period, and those that trigger the running of the period in the first instance).

Contrary to respondents' suggestion (Br. in Opp. 7), Section 16(b)'s explicit reference to "the date such profit was realized," 15 U.S.C. 78p(b), does not preclude application of the discovery rule. In *Exploration Co.* v. *United States*, *supra*, for example, the Court applied the discovery rule, although the statute at issue provided that "suits to vacate and annul patents hereafter issued shall only be brought within six years after the date of the issuance of such patents." 247 U.S. at 445 (quoting Act of Mar. 3, 1891, ch. 561, 26 Stat. 1099). And in *Delaware State College* v. *Ricks*, 449 U.S. 250 (1980), although the pertinent limitations period provided that an EEOC charge "shall be filed within one hundred and eighty days after the alleged unlawful employment practice occurred," *id.* at 256 (quoting 42 U.S.C. 2000e-5(e) (1976)), the Court looked to when the employer "established its official position—*and made that position apparent*" to the claimant, *id.* at 262 (emphasis

added). There is no reason to depart from the "venerable principle[s]" of the discovery rule, *Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*, 501 U.S. 350, 363 (1991), with respect to claims under Section 16(b).

Respondents contend, however, that Section 16(b)'s limitations period should be regarded as "an outer limit, such as the 3-year portion of the period in [*Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*, *supra*], and not subject to equitable tolling." Br. in Opp. 9. The Court in *Lampf*, however, expressly recognized the general applicability of the discovery rule, and of principles of equitable tolling. 501 U.S. at 363. Its holding that those principles did not apply to the limitations provision for claims under Section 10(b) of the 1934 Act was based on the unique characteristics of that limitations provision.

The limitations provision at issue in *Lampf* provided that "[n]o action shall be maintained to enforce any liability * * *, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation." 501 U.S. at 360 n.6 (quoting 15 U.S.C. 78i(e) and 78r(c)). The provision thus combined an express discovery principle with an absolute period of repose. Observing that "the 1-and-3-year scheme represents an indivisible determination by Congress as to the appropriate cutoff point for claims under the statute," 501 U.S. at 362 n.8, the Court concluded that "the equitable tolling doctrine is fundamentally inconsistent with the 1-and-3-year structure," *id.* at 363. Here, by contrast, neither the language nor the structure of Section 16(b)'s limitations provision is inconsistent with application of the discovery rule, or with other equitable tolling principles. Compare *Crown, Cork & Seal Co.*

v. *Parker*, 462 U.S. 345, 349 n.3 (1983) (applying equitable tolling principles to limitations period for Title VII claims) with *United States* v. *Brockamp*, 117 S. Ct. 849, 852 (1997) (Section 6511 of Internal Revenue Code not subject to equitable tolling; "Section 6511's detail, its technical language, the iteration of the limitations in both procedural and substantive forms, and the explicit listing of exceptions, taken together indicate to us that Congress did not intend courts to read other unmentioned, open-ended, 'equitable' exceptions into the statute that it wrote.").[3]

Under the foregoing principles, the date of accrual for a claim under Section 16(b) is the date on which the securities transactions were, or reasonably should have been, discovered. The court of appeals therefore erred in concluding that the limitations period necessarily began to run in this case on the date (May 31, 1989) on which respondents realized their short-swing profits. Pet. App. 7-8.

2. As the court of appeals acknowledged (Pet. App. 6), disclosure pursuant to Section 16(a) is the statu-

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[3] Respondents also contend (Br. in Opp. 7) that Section 16(b)'s limitations provision is "jurisdictional," and that tolling principles therefore do not apply. Specifically, they assert that Section 16(b)'s limitations period "occurs in the same sentence that grants jurisdiction and provides the authorization for the institution of such suits." *Ibid.* Respondents are incorrect. Section 16(b) merely establishes a cause of action; it does not, as respondents suggest, confer jurisdiction. Jurisdiction is conferred by Section 27 of the Act, 15 U.S.C. 78aa, entitled "Jurisdiction of Offenses and suits." Cf. *Zipes* v. *Trans World Airlines, Inc.*, 455 U.S. 385, 394 (1982) ("The provision [of Title VII] specifying the time for filing charges with the EEOC appears as an entirely separate provision, and it does not speak in jurisdictional terms or refer in any way to the jurisdiction of the district courts.").

tory mechanism for providing notice of an insider's short-swing transactions. "Effective operation of Section 16(b) is made possible by Section 16(a)'s requirement of full and prompt publicity." *Whittaker* v. *Whittaker Corp.*, 639 F.2d at 528 (quoting Note, *The Scope of "Purchase and Sale" Under Section 16(b) of the Exchange Act*, 59 Yale L.J. 510, 512 (1950)). In the vast majority of Section 16(b) cases, the plaintiff has no reason to be aware of an insider's short-swing transactions before a Form 4 report is filed. See 2 Thomas L. Hazen, *Treatise on the Law of Securities Regulation*, § 12.2, at 19 (2d ed. 1990) (a central purpose of Section 16(a) "was to provide the information necessary to trigger the enforcement provisions of section 16"). Thus, the overall scheme of Section 16 *presupposes* the prompt filing of the reports provided for under subsection (a), followed by the opportunity for filing suit under subsection (b).

Moreover, "[w]hen Congress passed the act in question the [discovery] rule of *Bailey* v. *Glover* was the established doctrine of this [C]ourt. It was presumably enacted with the ruling of that case in mind." *Exploration Co.* v. *United States*, 247 U.S. at 449. See also *North Star Steel Co.* v. *Thomas*, 115 S. Ct. 1927, 1930 (1995) ("it is not only appropriate but also realistic to presume that Congress was thoroughly familiar with [this Court's] precedents * * * and that it expect[ed] its enactment[s] to be interpreted in conformity with them") (quoting *Cannon* v. *University of Chicago*, 441 U.S. 677, 699 (1979)). In light of that canon, and reading Sections 16(a) and 16(b) *in pari materia* to effectuate their common purpose, see *Gustafson* v. *Alloyd Co.*, 115 S. Ct. 1061, 1067 (1995), the limitations period for claims under Section 16(b) begins to run when an insider files a Form 4 report

disclosing the relevant purchases and sales. See D. Cook & M. Feldman, *Insider Trading Under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 413-414 (1953). The Act contemplates that as of that point, potential plaintiffs under Section 16 reasonably should discover any actionable short-swing transactions. See *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344, 350-351 (1943) ("[C]ourts will construe the details of an act * * * so as to carry out in particular cases the generally expressed legislative policy.").

Referring to Section 16(a) to determine the general operation of the discovery rule in this setting also is supported by Section 16(b)'s focus on security holders, who have "the ultimate authority to sue for enforcement of § 16(b)," *Gollust* v. *Mendell*, 501 U.S. 115, 122 (1991),[4] and for whom disclosure under Section 16(a) is the only available source of information regarding short-swing transactions.[5] That approach

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[4] The Commission has no authority to enforce Section 16(b).

[5] This understanding of the importance of Section 16(a) to stockholders is supported by the testimony of Thomas G. Corcoran, a principal drafter of the bill, at one of the hearings on the 1934 Act:

> MR. MERRITT. Well, of course, as a matter of fact, as a matter of actual practice, if I sell my own stock, the stockholders are not going to know whether I sell or not.
>
> MR. CORCORAN. No; but the stockholders ought to be in a position where they can know, and under section 15(a) [the present Section 16(a)] they would be.
>
> MR. MERRITT. Any time a director sells some stock, he does not send a notice to all of the stockholders that he has sold his stock?

also avoids the dangers inherent under Section 16(b) in imputing to a corporation or other issuer knowledge of short-swing transaction information available to its officers or directors, when those officers or directors include insiders who have engaged in short-swing transactions. Absent a rule that looks to disclosure under Section 16(a), "[c]ollusion among insiders and, a more likely occurrence, the unarticulated acquiescence in or averting of gaze from a powerful insider's transactions," could thwart the purposes of Section 16. *Whittaker* v. *Whittaker Corp.*, 639 F.2d at 529.[6]

MR. CORCORAN. No; not every one; but once a month the bill would require him to report what his stock changes are. Otherwise the insider is at a decided advantage.

Hearings on H.R. 7852 and H.R. 8720 before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 136 (1934). Compare *Gollust* v. *Mendell*, 501 U.S. at 125 n.7 (discussing Mr. Corcoran's testimony on the incentive of shareholders to sue).

[6] The court of appeals stated that "[t]here is * * * record evidence that [petitioner]—which, as noted, is controlled by Starion, the same entity that purchased [respondents'] shares—had actual and contemporaneous notice of the [respondents'] short-swing profits." Pet. App. 8 n.2. However, because the court held that petitioner's complaint was untimely even if the limitations period was tolled during respondents' noncompliance with Section 16(a), it did not decide "whether [petitioner's] putative knowledge renders the equitable tolling doctrine inapplicable." *Ibid.* For the reasons discussed above, we believe that Section 16(b)'s limitations period begins to run when the transactions are disclosed pursuant to Section 16(a), whether the plaintiff is a security holder or (as in this case) the issuer. But even if the limitations period begins to run when an issuer-plaintiff learns of a short-swing transaction before the filing of a Form 4 report, the court of appeals erred in failing

Finally, this Court has directed that, "where alternative constructions of the terms of Section 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders." *Reliance Electric Co.* v. *Emerson Elec. Co.*, 404 U.S. 418, 424 (1972). That purpose is best served by a straightforward rule that looks to the date on which notice of short-swing transactions is provided under Section 16(a). See *Gollust*, 501 U.S. at 121, 122 (Section 16(b) imposes a "flat rule" rendering insiders liable for short-swing profits "even if they did not trade on inside information or intend to profit on the basis of such information."); *Blau* v. *Lamb*, 363 F.2d 507, 516 (2d Cir. 1966), (Section 16's "success as a deterrent [is] rooted in its simplicity and relatively automatic operation."), cert. denied, 385 U.S. 1002 (1967); 2 Hazen, *supra*, § 12.3, at 24 ("Section 16(b) was intended to be straightforward in application thus providing the predictability necessary for sound planning.").

3. The question presented in this case has not been frequently litigated. As the court of appeals acknowledged (Pet. App. 8), however, the decision below directly conflicts with *Whittaker* v. *Whittaker Corp.*, *supra*, in which the Ninth Circuit held that "[t]he two-year period for § 16(b) begins to run when the transactions are disclosed in the insider's § 16(a) report." 639 F.2d at 530. As a result, litigants in the Second and Ninth Circuits now face different limitations periods for the identical conduct under the 1934

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to determine whether petitioner in fact possessed such knowledge in this case.

Act. Those circuits account for a significant proportion of cases brought under Section 16(b).

The different calculations employed by the Second and Ninth Circuits result in a difference of at most 40 days in the period available for filing an action to recover short-swing profits for the issuer.[7] That divergence does not substantially shorten the time for filing suit in the Second Circuit, or create a substantial incentive for forum shopping. Nevertheless, as this Court has observed, "[f]ew areas of the law stand in greater need of firmly defined, easily applied rules than does the subject of periods of limitations." *Wilson* v. *Garcia*, 471 U.S. 261, 266 (1985) (quoting *Chardon* v. *Fumero Soto*, 462 U.S. 650, 667 (1983) (Rehnquist, J., dissenting)). The limitations period at issue here, moreover, pertains to a provision that Congress intended to serve as a virtually automatic means of ensuring that insiders would not retain

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[7] Petitioner contends (Pet. 11) that a Section 16(a) report as to certain types of transactions would not become due until as much as a year and 45 days after the short-swing transaction, and that, under the court of appeals' holding in this case, all 410 of those days would be counted against the limitations period. Petitioner is correct that, pursuant to Rule 16a-3, 17 C.F.R. 240.16a-3, an insider may report certain transactions on a Form 5 within 45 days after the fiscal year's end. Such transactions, however, must be largely exempt from Section 16(b). Petitioner is incorrect in contending (Pet. 11 n.4) that the mere *claim* of an exemption preserves the timeliness of a Form 5 filing, even if the transaction is not, in actuality, exempt from Section 16(b). A mere claim of exemption from Section 16(b) does not render a Form 5 filing a timely reporting of the transaction. If the transaction in fact is not exempt from Section 16(b), it must be reported in a Form 4 report, and the insider would be delinquent in only later reporting the transaction through a Form 5.

short-swing profits. That legislative purpose is undetermined by inconsistency among the courts of appeals regarding the proper time for filing claims under Section 16(b). Accordingly, on balance, we believe that review is warranted.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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